

**The World Bank One Year After  
The Commission's Report to Congress**

**by Allan H. Meltzer**

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The World Bank, including IDA, disbursed to its client countries \$24 billion in 1999 and \$18.5 billion in 2000. The budgeted cost for making and managing these disbursements is relatively high, almost \$1.5 billion or more than 7% of average disbursements. The cost to the donor countries is higher still, a multiple of the operating costs paid by the Bank. The Commission estimated the cost of the principal development banks to U.S. taxpayers at \$5 billion per annum.

Last year, the International Financial Institution Advisory Commission (IFIAC) described the Bank as costly, inefficient, bureaucratic, ineffective, and lacking clear objectives. Its credo is "a world free of poverty." The Commission claimed that it had no effective means of achieving its objective. The Bank's President and its officials publicly denied many of the Commission's statements. The facts are clear and simple to relate. Between 1987 and 1998 the number of people living on less than \$1 a day, the Bank's measure of extreme poverty, remained the same. The proportion of the population declined modestly from 28% to 24%. This is not much of an accomplishment for an expenditure of about \$200 billion current dollars.

Recently, the Bank has started a reappraisal. The press has reported on a memo written by staff of one of the Bank's major divisions in response to a request last December from President Wolfensohn for a discussion by all divisions of the Bank's problems. The memo is unsigned, but it states that it represents "consensus views that emerged from discussions among the managers and staff" of the division.

A reader of the internal Bank memo gets a picture of an ineffective organization with low morale and uncertain direction. The memo lists five major problems at the Bank.

- "President's management and leadership style.
- An overload of institutional mandates and a lack of clear direction.

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\* I want to acknowledge assistance of World Bank staff in providing information on recent and proposed changes.

- Problems at senior management levels.
- Inadequate resources for the work...

[and]

- The high degree of negativity among the staff."

To amplify these charges, the memo says that the President's proposals "while perhaps individually worthwhile, have tended to diffuse the Bank's focus. Their importance in individual countries [is] often unclear. The ideas have not been accompanied by adequate resources for implementation." In other words, the Bank is not organized to assist countries to develop their economies and improve the quality of life for their citizens.

Further, the memo charges:

"The Bank today has no focus and is driven by an ever growing list of mandates imposed on it through a variety of means---President's favored subjects..., Board sentiments..., public pressures, ideas generated by internal constituencies, and even fads. ...

"No initiative that starts as a pilot is ever considered a failure because of a lack of any honest evaluation." World Bank memo, Feedback from MNA Staff and Managers (undated 2001).

These are serious charges that go in the same direction, but much beyond, what the Commission said in its Report. Better use of the \$20 to \$25 billion of annual disbursements should be an urgent concern of the Bank, its donors, the recipients, the Congress and the new administration.

An effective response to these issues would neither accept them as entirely true, reject them as false, nor ignore them. The donor countries should take two steps. First, they should require an independent management audit to appraise the organization. In a paper prepared last year for the Commission, Tom Faught concluded that the Bank's so-called matrix form of organization is inefficient and ineffective.<sup>1</sup> Some of the Bank staff now reach the same conclusion. A thorough reorganization to develop effective incentives to reduce poverty, achieve development, establish market economies and democratic government appears necessary.

Second, the donors should require a performance audit of Bank lending and aid. The Commission, using tabulations made by the Bank's staff from the Bank's records, concluded that

the Bank had an overall 55 to 60% failure rate to achieve sustainable results and a much higher failure rate, 70%, in the poorest countries. Although these data come from tabulations supplied to the Commission by the Bank's staff, Bank spokesmen have disputed their accuracy. We have no independent way of measuring program results. We believe that an independent performance audit is an urgent necessity. The audits should show the Bank's successes and failures three to five years after projects are completed. They should be published. The Bank does very limited amounts of post-project evaluation. Taxpayers, donors, recipients, and the Bank's staff and management should welcome an independent evaluation of its successes and failures. This is an important step toward improvement.

The two most important reforms are: (1) choose a consistent set of objectives based on known and accepted criteria for success, and (2) shift from the current command and control approach to reliance on incentives and monitoring. The Bank gives lip service to local autonomy but chooses programs based mainly on the whims of non-elected NGOs, the Bank's President and in ways named in the internal memo quoted above. We will not achieve the paramount aim of improving living standards while spreading democratic government as long as programs are chosen by the Bank acting with the NGOs. Democratic accountability and sustained progress require that local officials learn to make the hard decisions. That will not happen until they have the incentives to do so.

Incentives is one of the central threads that run through the Commission's report on the IMF and the development banks. The Bank should support and subsidize economic and social development and improvements in the quality of life and should monitor results much more than it currently does.

The Commission proposed five broad sets of activities or changes. First is a grants program to improve the quality of life even in countries where governments are corrupt, venal, or unwilling to develop the necessary rules, laws, and institutions that economic development requires. Countries would choose the program, but money would be disbursed to vendors only after a performance audit established that the work had been done. The money would be paid as grants, directly to the vendors or suppliers, so there would be no debt and reduced theft and misappropriation.

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<sup>1</sup> Thomas Faught, Jr. "Management, Incentives, and Administration at the World Bank" in *Expert Papers*, Washington: Government Printing Office for the International Financial Institution Advisory Commission, March 2000.

Adam Lerrick, a member of the Commission staff, showed that the proposed grants program would be less costly than the current system of lending and could be done entirely from the resources that the development banks currently have. I am pleased to report that in a recently published memo, Michael Klein of the Bank's staff endorses a very similar program.

Klein writes: "Decades of aid provision have failed to support growth and to provide basic services to the poor. Not only that, foreign debt has slowly accumulated in many poor countries to the point that they cannot pay back."<sup>2</sup> The proposal is not World Bank policy, but it is under consideration. Last week at the IDA 13-replenishment meeting in Paris, the task force proposed that "limited use of grants could be explored cautiously."

The second proposed change is to introduce incentives for undertaking and continuing institutional reforms. The Commission proposed to heavily subsidize interest rates and to delay repayment of loans for countries that undertake to establish and expand institutional reforms. To develop growing economies and political democracy, countries must be open to trade, expand property and personal rights, and develop their institutions. The Bank has not made much progress on these critical changes.

Third, the development banks should encourage regional cooperation in solving the problems of disease, pollution, forestry, and agriculture. The Bank now acknowledges that it has been slow to act on so-called global or regional public goods. It has accepted this criticism and began to implement alleviation of AIDS in Africa. This is encouraging. Much more must be done across countries in disease, agriculture, forestry, and the environment.

Fourth, over a five-year period, the development banks should phase-out lending to countries that reach \$4000 per capita income or an investment grade rating for their debt. Countries with capital market access can and should obtain desired loans from the market, a much larger supplier of capital. The development banks should continue to provide technical assistance, where invited to do so. They should reserve grants, lending, and subsidies for the poorest countries. Last year, the World Bank criticized this proposal mainly on the bogus grounds that loans to middle income countries provide resources that can be used in poorer countries. This claim is false. It is surprising and disconcerting that the Bank's President was not aware that his written statements to this effect, and published statements by his senior staff,

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<sup>2</sup> Michael Klein: "Beyond Debt Relief - New Opportunities for Private Investors" Washington: The World Bank, 2001.

are false. Recently, the Bank has started to reconsider its role in middle-income countries with access to capital markets. It has appointed a task force to reconsider its role. However, it has not introduced a policy of phasing out financial assistance to these countries.

Fifth, overlap between the World Bank and the regional development banks should be phased out. The World Bank should be a source of technical assistance to all countries and to other development banks. It should concentrate its financial assistance principally in the poorest African countries. Provision of grants and development lending in Asia and Latin America should be the sole responsibility of the regional development banks.

The World Bank's initial reaction to the Report was hostile and obfuscating. The Bank's management has devoted much of its strategic effort to developing cliché-ridden, ambiguous statements such as the Comprehensive Development Program and, more recently, the Sustainable Framework Paper. These statements contain many words about goals and directions that are attractive. Most of us share the main objectives. Very little is said about how the Bank would motivate its own and other organizations to achieve these objectives by structuring incentives for client countries and within its own organization. The idea that performance and achievement depend on incentives and effort does not appear.

The Strategic Framework Paper,<sup>3</sup> however, recognizes the need to emphasize regional public goods, to reduce overlap with the IMF, to integrate the group's private sector agency (IFC) more fully into the Bank's work, and to harmonize activities with regional development banks. These steps, if taken, would move in directions the Commission advocated. Also, we can hope that the current turmoil within the Bank may bring bona fide reform. I believe a performance audit and a management audit would improve information about the Bank, its ineffectiveness and inefficiencies, thereby making reform more likely. These audits would help the donor countries to understand why the Bank has been relatively ineffective in alleviating poverty in the poorest countries. Real progress will not occur without organizational restructuring to increase performance incentives for the Bank's staff and within the client countries.

Poverty reduction is difficult and challenging. The Commission has no illusion that it will be done quickly. But, we believe that very little will be achieved without major reforms of the type we proposed, reforms that introduce incentives for the countries to decide to make and maintain the necessary changes.

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<sup>3</sup> World Bank, November 30, 2000. This is a draft version that may be revised.

## Final Comments

I would like to use my few remaining minutes to comment on the reception that the Commission's proposals have received outside the United States. In the past year, I have traveled and spoken about the report in Belgium, Canada, Central America, Germany, Japan, Switzerland, and the U.K., in addition to the United States. In each of these countries, and with representatives of the French and Italian central banks, the Bank for International Settlements, the European Central Bank, and the European Union, I spoke with official representatives. I believe I can assure you that there is considerable support for many of the Commission's recommendations. The German Bundesbank and the Bank of Canada reached similar conclusions about the IMF by themselves.

A recent issue of *The Economist* magazine gives an assessment that accords with my experience. It wrote:

"It is also encouraging that a useful blueprint for reform--a starting point at any rate--is already at hand. Last year, making itself heard above the general racket, was a plan set out by the Meltzer Commission. ... The group did not achieve unanimity, but it did produce a report that commanded support from across the ideological spectrum, laid down some radical yet sensible basic principles..." "Reforming the Sisters" *The Economist* (February 17-23, 2001, p. 24)

The Annual Report of the UK Chancellor of the Exchequer states the need for "internationally-agreed codes and standards ...allowing financial markets to make informed investment decisions."<sup>4</sup> Elsewhere, the Chancellor's Report discusses agreement by the G-7 governments that "responsibility for negotiations with private creditors should rest with debtor countries. ... No class of creditors should be considered inherently privileged." (Ibid., p. 12) The report also endorses pre-qualification for assistance in a crisis. The aim is to create the right incentives for the adoption of strong policies and adherence to international recognized standards." (Ibid., p. 16) In September, the IMF adopted this statement as part of its reform proposal. These recommendations accord well with the Commission's recommendations. The Appendix discusses other changes and recommendations.

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<sup>4</sup> "Annual Report to Parliament on UK Operations at the International Monetary Fund" October 1999-September 2000, p. 4. [www.BritainUSA.com](http://www.BritainUSA.com)

In closing, I want to emphasize four points. First, we cannot afford, and should not continue, a system that generates expensive crises with extraordinary frequency. It must be reformed. Economic progress here and elsewhere requires a more stable system than the current IMF provides. Second, we must rid ourselves of a system that imposes changes that countries do not want and will not enforce, that brings demonstrators to the streets protesting real and imagined wrongs, and that is ineffective. Third, we must encourage the poorest countries, and others, to choose paths to economic and social development that are known to work. They must have the incentive to do so. Fourth, we must insist on performance and management audits to learn how effective these organizations are and to give them incentives to improve.

Mr. Chairman, you took leadership on issues of IMF accountability and effectiveness years ago. The new administration recognizes that global peace and stability requires blending economic, military, and political programs. The best time for lasting reforms is when there are no crises. That time is now. I welcome the opportunity to appear here today. I hope this is an additional step toward keeping reform of the IMF and the development banks moving forward by implementing the Commission's principal recommendations.



## **Appendix**

This is a partial list of proposed and actual changes by the IMF in the past year.

The IMF has produced a series of experimental reports on the Observance of Standards and Codes. These assess member countries' progress in implementing codes and standards of best practice. The IMF provides assessment of the codes and standards and seeks countries' permission to publish its findings. The IMF now makes recommendations to improve implementation of standards.

The IMF and the World Bank jointly established a financial sector assessment program for financial systems, banking supervision, and transparency.

In April 2000, the IMF members agreed that responsibility for negotiation with private creditors should rest with debtor countries.

Discussions by the IMF Executive Board have moved from denial of moral hazard to an effort to assess its extent.

Perhaps the most progress has come in information and transparency of operations. The IMF now makes its liquidity position public. It publishes, on a voluntary basis, Article 4 staff reports. By December 2000, 60 countries published their reports.

The IMF will establish this spring an Independent Evaluation Office. Reports will be published.

The IMF reduced the number of its lending programs, taken steps to reduce long-term lending from the Stand-by and Extended Fund Facility, and changed the terms and rules of the Contingent Credit Facility to make it more useful.

Much more is needed. Recent bailouts in Turkey and Argentina show that change is slow in practice. These signs of change in response to criticisms are a welcome start toward a system that is more effective, less costly, more responsive on market decisions, and less crisis-prone.